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SUBJECT: IMF SEES TALL 'GREEN SHOOTS' WITH SHALLOW ROOTS IN ZAMBIA

REF: A. LUSAKA 571
¶B. LUSAKA 749

SUMMARY

¶1. (U) At the conclusion of a two-week IMF mission to Lusaka on October 28, mission chief George Tsibouris told donors that the Zambian economy is performing better than expected and that the IMF now expects real GDP growth to exceed 5 percent in 2009, up from an August estimate of 4 percent (Ref A). The IMF expects similar GDP growth in 2010. Inflation, at 13 percent in September, is projected to fall to 12 percent by the end of the year. (Note: October statistics released after the IMF team's departure reported October inflation at 12.3 percent.) Zambia's reserves are at a healthy USD 1.75 billion, including over USD 600 million in IMF Special Drawing Rights (SDRs), and the government has a manageable debt load. Tsibouris cautioned that, while Zambia recovered quickly from the global economic downturn, the GRZ must address structural weaknesses to strengthen the economy's ability to weather the next downturn. END SUMMARY.

ZAMBIA'S FUTURE LOOKS BRIGHT

¶2. (U) On October 28, IMF mission chief George Tsibouris briefed donors on the results of the Fund's two-week mission for the 2009 Article IV consultations with the Zambian government (GRZ) and for the third review of Zambia's Poverty Reduction and Growth Facility (PRGF). Tsibouris reported that the Zambian economy was performing surprisingly well and that GDP growth would likely exceed 5 percent in both 2009 and 2010. A sharp rebound in global copper prices and a bumper maize crop helped to turn the economy around. Tsibouris also praised the GRZ's fiscal discipline in the face of falling government revenues and the Bank of Zambia's (BOZ) efforts to "smooth" the Kwacha's slide, which he said acted as a shock absorber for the economy. October inflation was at 12.3 percent, helped primarily by lower food prices, reduced imports and a somewhat stronger Kwacha. Tsibouris expected end of year inflation to be 12 percent, with inflation falling to about 8 percent by the end of 2010.

¶3. (U) The IMF reported that it had included in its 2010 program for Zambia up to USD 600 million in non-concessionary borrowing to fund energy and other infrastructure projects. Tsibouris explained that a prohibition on non-concessionary borrowing was too inflexible and that Zambia's debt capacity could comfortably absorb the non-concessionary debt. An IMF debt sustainability analysis determined that Zambia's debt, including GRZ debt, projected non-concessionary debt, and contingent liabilities such as pension obligations equaled approximately 25 percent of GDP. Preliminary results from a range of standard systemic downside scenarios showed that Zambia's debt load did not exceed 40 percent of GDP under any of the shock tests.

¶4. (U) Zambia's foreign reserves are at a record USD 1.75

billion, the highest level in 40 years. In July 2009, after spending considerable reserves to smooth Kwacha volatility during the economic downturn, the GRZ reported only USD 750 million in reserves. Total reserves include approximately USD 600 million in SDRs and represent more than four months of import coverage. The IMF expects modest reserve growth in ¶2010.

ADDRESS STRUCTURAL WEAKNESS FOR SUSTAINED GROWTH
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¶5. (U) While the IMF concluded that Zambia's economic outlook was good, Tsibouris cautioned that structural weaknesses that increased economic uncertainty still needed to be addressed to ensure that economic growth would be sustainable. Key challenges include public sector spending on infrastructure and the social sector to diversify the economy and reduce poverty. Until Zambia can diversify its economy, it will still be beholden to global copper prices and mother nature.

¶6. (U) The IMF based its 2010 program on the 2010 GRZ budget now being discussed in Parliament (Ref B). The budget includes almost USD 200 million in donor budget support (almost 6 percent of the total 2010 budget) that has not yet been approved by cooperating partners (CPs). Tsibouris reported that the IMF was not considering making up any revenue shortfall if donors withhold some level of assistance in 2010 and, given Zambia's economic performance and strengthening balance of payments, PRGF augmentation was unlikely as well. If donors did not come through, Tsibouris concluded, the IMF would look to the GRZ for some budget revisions.

¶7. (U) Tsibouris emphasized the need for the GRZ to focus on revenue collection, which has been deteriorating as a percentage of GDP. The GRZ intends to look closely at its tax policies and implementation in 2010 and make reforms to reverse the negative trendline. In the interim, the 2010 budget assumes a modest revenue collection improvement from 15.7 percent to 15.9 percent of GDP. In the past, infrastructure spending has usually been the first victim of revenue shortfalls.

¶8. (U) In the financial sector, the IMF is looking to the Bank of Zambia (BOZ) to play a more active role in improving systemic weaknesses. To free up liquidity in the market, the BOZ should work to develop a secondary market for treasury bills and create overnight lending facilities for banks to lessen their perceived need to hoard liquidity. The IMF team also concluded that the BOZ should create the capacity to be the lender of last resort for the Zambian financial system to be able to confront systemic crises.

COMMENT

¶9. (U) Tsibouris was surprisingly upbeat, and caught many of the gathered donors off guard (not us) with the IMF's rosy outlook for Zambia's economy. We continue to expect the Zambian economy to perform well so long as copper prices remain high and the rains arrive on time, and in sufficient volume, for the maize growing season. Unfortunately, Zambia's strong economic performance could cause the GRZ's focus on economic diversification to flounder as it has during past periods of robust copper-fueled economic growth.
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